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ALERTS

IRS Extends Opportunity Zone Deadlines

June 9, 2020

Highlights

IRS extends to December 31, 2020, a 180-day investment period ending on or after April 1, 2020

Failure of a qualified opportunity fund (QOF) to satisfy 90 Percent Asset Test disregarded for period April 1, 2020, through December 31, 2020

30-month substantial improvement period for designated properties tolled for period April 1, 2020, through December 31, 2020

Working capital safe harbor extended for up to 24 additional months

12-month reinvestment period for QOFs may be extended for up to 12 additional months

In response to the COVID-19 pandemic, IRS Notice 2020-39 extends several deadlines relating to the opportunity zone program and provides welcome relief for investors and qualified opportunity funds (QOFs).

In December 2017, Congress enacted an attractive tax incentive program to promote long-term investments in economically distressed communities

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designated as opportunity zones. Designated opportunity zones exist in every state and represent over 10 percent of the land mass in the United States, including nearly all of Puerto Rico. A taxpayer may realize the tax benefits of the opportunity zone program by investing up to the amount of any eligible capital gain in a QOF during the 180-day period beginning on the date the capital gain would have been recognized by the taxpayer. The QOF, in turn, invests in qualified opportunity zone property, which includes an investment in the equity of a qualified opportunity zone business.

Specifically, Section 1400Z-2 of the Internal Revenue Code provides the following tax benefits:

- **Initial Gain Deferral** – A taxpayer may elect to defer recognition of capital gains from other transactions to the extent the gain amount is invested in a QOF within the 180-day period beginning on the date the capital gain would been recognized by the taxpayer. The gain is generally deferred until earlier of: i) the date on which the QOF investment is sold or exchanged (or otherwise subject to an inclusion event), or ii) December 31, 2026.
- **Partial Reduction in Deferred Gain** – For investments in QOFs made after December 31, 2019, and before December 31, 2021, a taxpayer may permanently exclude from income 10 percent of the deferred gain if the QOF investment is held at least five years.
- **QOF Gain Exclusion** – If a taxpayer holds a QOF investment for at least 10 years, the taxpayer may generally elect to exclude from income any post-acquisition gain realized from the sale or other disposition of the QOF investment.

Deadline Extensions

Notice 2020-39 extends the following deadlines relating to the opportunity zone program:

180-Day Investment Period Extended to December 31, 2020

In Notice 2020-23, the IRS previously extended the 180-day investment period to July 15, 2020, if the last day of the 180-day investment period would have ended on or after April 1, 2020, and before July 15, 2020. Notice 2020-39 further extends that investment period until December 31, 2020, if the last day of the 180-day investment period would have ended on or after April 1, 2020, and before December 31, 2020.

90 Percent Asset Test for QOFs Relaxed for 2020

A QOF must hold at least 90 percent of its assets in “qualified opportunity zone property.” The 90 percent test is applied by measuring the average of the percentage of qualified opportunity zone property held by the QOF (relative to total assets) on i) the last day of the first 6-month period of each taxable year of the QOF, and ii) the last day of each taxable year of the QOF. Notice 2020-39 provides that any failure by a QOF to satisfy the 90 percent asset test during the period April 1, 2020, through December 31, 2020, will automatically be treated as having satisfied the reasonable cause standard for avoiding penalties. The notice further provides that any such failure will be disregarded for purposes of determining whether the QOF satisfies the requirements for qualifying as a QOF and whether investments in the QOF constitute qualifying investments.

30-Month Substantial Improvement Period Extended Nine Months

QOFs or qualified opportunity zone businesses that acquire existing tangible property must substantially improve that property within 30 months from the acquisition date. An existing property will be treated as substantially improved only if, during the 30-month substantial improvement period, the QOF or the qualified opportunity zone business incurs sufficient expenditures to double the tax basis of the existing property. Notice 2020-39 disregards the period beginning April 1, 2020, and ending December 31, 2020, in determining any 30-month substantial improvement period (that is, the 30-month substantial improvement period is tolled during those nine months).

31-Month Working Capital Safe Harbor Period Extended up to 24 Additional Months

In general, a qualified opportunity zone business may not hold cash or other “nonqualified financial assets” in excess of 5 percent of its total assets. An exception is provided for reasonable amounts of working capital held in cash, cash equivalents and debt instruments with a term of 18 months or less (working capital assets). The Treasury regulations provide a safe harbor under which working capital assets are treated as reasonable in amount if a) the amounts are designated in a written plan for the development of a trade or business, or for the acquisition, construction and/or substantial improvement of tangible property in an opportunity zone, b) there is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets within 31 months of receipt by the business of the assets, and c) the working capital assets are used substantially consistent with the written plan and schedule. Notice 2020-39 extends the 31-month working capital safe harbor period for not more than an additional 24 months, as long as the business otherwise meets the requirements to satisfy the working capital safe harbor. This extension apples to all qualified opportunity zone businesses holding working capital assets intended to be covered by the working capital safe harbor before December 31, 2020.

12-Month Reinvestment Period for QOFs Extended up to 12 Additional Months

The Treasury regulations generally permit a QOF that sells or disposes of some or all of its qualified opportunity zone property (or receives a return of capital from such property) to reinvest the proceeds into other qualified opportunity zone property within 12-months after the disposition or distribution. The proceeds, to the extent reinvested, will be treated as qualified opportunity zone property for purposes of the 90 percent test to the extent held in working capital assets prior to reinvestment. Notice 2020-39 extends this 12-month reinvestment period by up to an additional 12 months if the initial 12-month period was in effect on January 20, 2020, the QOF otherwise meets the requirements of the 12-month reinvestment period, and the QOF invests the proceeds in the manner originally intended before January 20, 2020.

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